The Street

IRS Lowers Mileage Reimbursement Rate Amid Low Oil Prices

By **Ellen Chang** **Follow**|12/28/15 - 08:15 AM EST

The IRS lowered the mileage reimbursement rate to 54 cents per mile for a business vehicle in 2016, which is a 3.5 cent decrease from 57.5 cents in 2015 as the prolonged oil glut has also pushed gasoline prices downward rapidly.

The IRS rate is a standard amount used by many companies to reimburse employees for the expenses of utilizing their own vehicles to conduct business meetings. Starting on January 1, the new rate will take effect.

The reduction could be attributed to the fact that gas prices have “consistently remained at a lower level than in past years,” said Tom O’Rourke, a tax partner at Haskell & White, an Irvine, Calif.-based accounting, auditing and tax consulting firm.

One method the IRS uses to calculate the mileage reimbursement rate is by compiling data from Runzheimer, a Waterford, Wis.-based company that designs workforce mobility and business vehicle programs. The data includes fixed and variable factors throughout the country such as fuel prices, auto insurance premiums and maintenance rates and vehicle depreciation, said Heidi Skatrud, a senior vice president at Runzheimer.

“The 2016 rate is 54 cents per mile, which is an average monthly reimbursement for national business drivers of about $900,” she said. “The gap between that rate and the ‘real’ cost of owning and operating a car in the U.S. is about $200 monthly.”

Maintenance and Taxes Add Up

There could be a further discrepancy among various cities and states since fuel and tax rates vary by each area. Business drivers in Detroit might rack up costs of $1,300 per month, which means if their job entails a lot of driving, the rate of reimbursement for each month might be too low by $400 if the employer only uses the IRS rate as a consideration.

“Employees need be aware of the discrepancies between the IRS rate and actual costs of operating a car, as the IRS rate is meant to be a safe harbor deduction rate," said Skatrud. “The rate is a national composite of the most popular vehicles in the U.S. and does not vary by geography, so employers need to implement a more dynamic system that varies with the market."

Beyond the normal wear and tear on a vehicle, other factors also impact the rate set by the IRS such as annual vehicle ownership costs such as depreciation and sales tax, tires, insurance and registration costs.

Managers can opt to follow an alternative non-taxable method called the fixed and variable reimbursement (FAVR) program, which provides reimbursement based on the employee’s location, mileage driven and a few other factors.

“FAVR programs bring consistency across all drivers, while still respecting that business vehicle costs can vary widely based on where an employee lives and drives,” Skatrud said. “Instead of reimbursement for every business mile driven, the fixed reimbursement is often payable monthly to cover costs that typically remain the same throughout the year.”

Lowering Tax Liability

Mileage deductions help both small businesses and contract workers lower their tax liability, said Joseph Rehm, a licensed tax professional at Tax Defense Network, a Jacksonville, Fla.-based tax resolution company.

“If you travel extensively for work and rely on fuel deductions, you may want to consider some coming changes in mileage rate deductions,” he said. “In other words, 54 cents for every mile you travel will be the limit of what you are permitted to deduct on your tax return. The IRS has established the new low deduction rate based on information provided by Runzheimer, a business vehicle system it has used for nearly 36 years.”

The lower prices for crude oil and gasoline are part of the reason the IRS lowered the reimbursement rate, so taxpayers who “rely heavily on fuel deductions in lowering their overall tax bill may want to adjust their financial planning for 2016 to compensate for the lower rates,” Rehm said.

Consumers looking for other tax breaks might consider other deductions such as purchasing new business equipment or adding staff members, he recommended.

The mileage rate for medical or moving transportation will decrease from 23 cents to 19 cents, and this change is “more dramatic because it only reflects fuel costs” and does not factor in maintenance or depreciation costs, said Mike Hoffman, professor of taxation at Nova Southeastern University Fort Lauderdale, Fla.

“Since the change in the standard mileage rate happens every year, most taxpayers are used to shifting to using the new numbers on January 1,” he said. “What is interesting is that the rate fell. While it is unusual, such a decrease in the mileage rate is not unheard of since the 2014 rate dropped by 0.5 cents per mile compared to 2013.”

Whether you are a freelancer or contractor, keeping track of your mileage throughout the year will save you the headache of calculating them in the spring. If the amount of your mileage is similar from last year, expect a smaller standard mileage deduction, said Andrew Oswalt, a tax analyst for TaxAct, a Cedar Rapids, Iowa-based tax preparation company.

“For example, if they drove 10,000 business miles in 2015, their standard mileage deduction would have been $5,750,” he said. “If they drove 10,000 business miles in 2016, their standard mileage deduction would be $5,400. It may not be a huge difference, but it could definitely change a business owner’s tax bill.”